
EXPLORATION INC.
Bellator

Nineteen Ninety-Six Annual Report

# Corporate Profile

*Bellator Exploration Inc. is a growth oriented, Calgary based junior oil and gas company, engaged in exploration as well as the acquisition and development of oil and natural gas properties in Western Canada.*

The corporation is committed to enhancing shareholder value through strategic acquisitions, successful exploration and development programs, and the prudent management of corporate resources.

Bellator is a public company listed on The Alberta Stock Exchange and trades under the symbol “BEX”.

## COVER

The word “Bellator” is Latin for warrior and this year’s cover continues the theme of Roman antiquity that we established two years ago. The montage of images conveys a bolder, more aggressive direction that symbolizes the tremendous growth Bellator has achieved in 1996.

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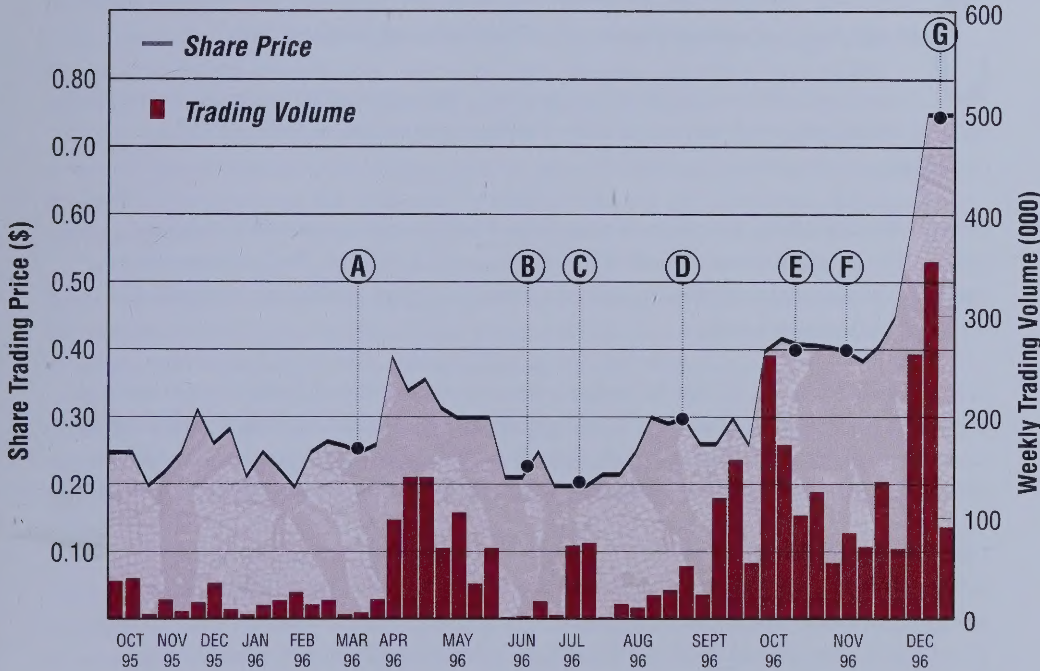
# 1996 Highlights

## Share Trading Activity:




**A March**
*Sold Rosebank property for $1.2 million ($22,000/bopd).*

**B June**
*Purchased private company (Alsask/Milton properties) for $0.4 million.*

**C July**
*Increased production at Alsask/Milton by 300%.*

**D September**
*Purchased private company which added large undeveloped land base and prospect inventory in Sounding area.*

**E October-November**
*Raised $1.3 million for fall drilling program.*

**F November**
*Drilled and cased 3 successful wells out of a 4 well program. Purchased private company which added 200 boepd and established a new core area at Lloydminster.*

**G December**
*Purchased producing properties and undeveloped land in Antelope area which added 220 boepd.*

*Exit 1996 production 520 boepd.*

**January (1997)**
*Signed letter of intent to purchase private company which added 500 bopd. In conjunction with the acquisition Bellator signed an underwriting agreement to raise $8.0 million (see note 8).*

*Sold Joffre undeveloped acreage for $1.6 million, recording a gain of $1.4 million.*

# PRESIDENT'S MESSAGE

***Since inception, Bellator has concentrated on value added strategies that minimize risk yet provide growth. Bellator's objectives for 1996 were to divest of non-strategic assets and to build critical mass through acquisitions to enable future growth in production and reserves. By the year ending September 30, 1996 we were well on the way to fulfilling these objectives and by the new fiscal year ending December 31, 1996 we had easily surpassed them.***

Indeed, our performance to the end of December, 1996 re-defined Bellator as a strong junior oil and gas producer, with a well balanced portfolio of drilling opportunities, undeveloped land and a proven reserve base.

Bellator believes in owning 100 percent working interest and maintaining operatorship wherever possible. This strategy prevents potential delays regarding capital programs, allows management to concentrate on productive activities, and reduces information sharing, resulting in a competitive advantage within our core areas.

In choosing our core areas, Bellator has limited its search to regions where it believes it has a technical edge, and where there is an opportunity for market entry through land and production acquisitions. In order to balance risk while maintaining high working interests, Bellator is focusing on areas that have shallow multi-zone potential, are accessible year round, and have ready access to market.

### 1996 REVIEW

Bellator entered 1996 with the intent of rationalizing its non-strategic assets and concentrating its activities in a new core area at Sounding-Hoosier. The first step was the divestment of the Rosebank property in March, 1996 and the elimination of bank debt which left Bellator in a much stronger financial position.

Between June, 1996 and December, 1996 the Company made a series of acquisitions in the Sounding-Hoosier area and by the end of the calendar year had established itself as a major player in the area, with an average 83 percent working interest in over 65 sections of land.

In August, 1996 Bellator looked to expand its focus and developed a second core area at Lloydminster. In November, 1996 Bellator established itself in Lloydminster through the acquisition of a private company. Bellator has a 100 percent working interest in all of its lands within this new core area and is actively pursuing other opportunities in the Lloydminster area.

Bellator made great strides in increasing production, reserves and land holdings in 1996. From a scant 1.2 bopd (all that remained after the sale of our Rosebank property) the Company rapidly increased production through key acquisitions and exploitation. Exit production rates for 1996 were 520 boepd, compared to the 1995 exit rate of 55 bopd. Proven and probable reserves increased to 3.3 million boe by December 31, 1996 from the previous year's 0.21 million boe, while land holdings increased to

42,500 net acres from 2,800 net acres in 1995. Opening 1997 production will increase to 1,020 boepd based, in part, on an acquisition scheduled to close in February, 1997.

### Entering 1997

Bellator's focus for 1997 is growth in production and cash flow, both overall and on a per share basis, through a combination of acquisitions, exploitation and exploration. Acquisitions have played a significant role in Bellator's success to date and will continue in the future.

At the same time, we anticipate that a large part of our growth in 1997 will come from the exploitation of current properties through the optimization of existing production and an aggressive development drilling program.

Bellator has budgeted for a 32 well drilling program which is comprised of 28 development oil wells and four exploratory gas wells in 1997. This drilling program should increase the Company's production to an average 1,800 boepd in fiscal 1997, with a targeted exit rate of 2,700 boepd.

Although exploration will play a small role in 1997 growth, Bellator believes it is important to gradually expand this component of our capital budget as cash flow improves. However, because Bellator has a large inventory of development activities, the exploration cycle can slowly and properly mature over time.

### Gaining a Competitive Edge

We believe the key to Bellator's success is a Management Team that is comprised of highly competent and strongly motivated individuals capable of acting in concert as a team. To that end, Bellator has assembled a group of people that understands the Company's goals and strategies, remains focused through excellent communication and is working diligently to properly execute its plan. Bellator's Management Team is a complement of technical and financial expertise with the skills and energy necessary to help Bellator achieve and exceed its goals and objectives for growth and profitability.

I would like to thank the Board of Directors for their wisdom and guidance through this challenging transition period, and our shareholders for their continued loyalty to our endeavors.

On behalf of the Board of Directors,

Robert J. Zakresky, CA
President
February 13, 1997

# 1996 Review of Operations

***In 1996 Bellator underwent a major transition that has positioned the Company for a period of rapid growth in production and reserves. This transition included the sale of two of our existing properties which allowed Bellator to strengthen its holdings in two newly defined core areas.***

With the transition behind us, Bellator has a better definition of itself as a junior oil and gas producer. Essentially, we believe the following fundamentals will allow us to achieve a competitive edge among our peers:

**Narrow geographic focus:** Bellator has carved out two main areas of geographic focus. The first of these includes the Sounding area of east-central Alberta and the adjacent Hoosier area on the Saskatchewan side of the border. The second core area is the Lloydminster area which straddles the Alberta-Saskatchewan border.

**Low risk development projects:** Both core areas offer prolific production potential from multiple zones through shallow, vertical wells. Other characteristics include low drilling costs, spare plant capacity and a high percentage of open crown and freehold land.

**Balanced production:** Bellator's current production is weighted toward crude oil, however our core areas offer considerable potential for natural gas production. It is our intention to develop both commodities as opportunities arise.

**Talented Management Team:** The core areas are managed by a highly competent team with many years of experience in the areas, combined with the financial discipline to carry out the business plan.

**From left:**
***Greg Fisher,*** Controller
***Sean Monaghan,*** Director
***Edith Andrew,*** Accounting Clerk
***Rob Jepson,*** V.P. Land and Director
***Gary Anderson,*** V.P. Operations
***Rob Zakresky,*** President and Director
***Paul Whitby,*** Exploration Manager
***Don McMorland,*** Director

## 1996 Property Sales

As part of its transition process, Bellator rationalized non-strategic properties and strengthened land holdings in its new core areas. The first stage of this process was the sale of our non-operated interest in the Rosebank property in March, 1996 for total proceeds of $1,200,000 or the equivalent of $22,000/boepd. The proceeds were used to eliminate bank debt and pursue high working interest, operated properties through which Bellator could better control its own destiny.

At the same time, Management determined that the Joffre project would have to be either accelerated or sold. During 1996, efforts to increase the Company's interest in the Joffre Viking Tertiary Oil Unit ("JVTOU") met with limited success and as a result, Management made a decision to sell the project. In January, 1997 Bellator completed the sale of its minor working interest in the JVTOU, together with 4,400 net acres of undeveloped land immediately offsetting the JVTOU, for $1,600,000. As a result, the Company will realize a gain of approximately $1,400,000 in 1997.

## Winter Drilling Program

In January, 1996 Bellator drilled two exploratory wells in the Sounding-Hoosier area. Although both were unsuccessful, the wells provided the Company with valuable exploration information and there remains the potential for further drilling on both prospects.

## June Acquisition

In June, 1996 Bellator acquired two 100 percent owned Detrital oil properties in the Sounding-Hoosier area, through the purchase of a private company. An optimization program was conducted and new equipment installed, raising production from the five wells to 80 bopd from 25 bopd. In mid-August, Bellator began building a new central battery and injection facility to reduce operating costs and increase the overall performance of the operations. The new facility will enable the Company to proceed with full scale development of the property and ultimately increase production to approximately 400 bopd. Through knowledge gained from the acquisition, Bellator identified additional pools in the area which would be ideal candidates to infill drill and waterflood and is actively pursuing several of these opportunities.

## September Acquisition

An acquisition in September, 1996 added 25 sections of high quality land to our undeveloped land holdings in the Sounding-Hoosier area, as well as detailed geological mapping and over 1,000 kilometres of seismic data that had been collected for a regional project over several years. Our technical team has used this data to identify 13 drillable prospects on these lands, with over 30 bcf of gas potential. The acquisition also included 100 kilometres of 1995-96 seismic data specifically covering the prospect lands. This recent seismic data is currently being integrated with the regional seismic and will be used to select optimum drilling locations.

### Fall Drilling Program

In November, 1996 the Company entered a four well drilling program in its Sounding-Hoosier core area. Bellator drilled two successful step-out oil wells at its Alsask property and one successful oil well at its Milton property. The Company is currently performing extended production tests on its two new wells at Alsask with highly encouraging initial results. At Milton, the Company plans to further evaluate the results of the well and tie it into existing facilities during spring, 1997.

Also as part of its fall drilling program, Bellator drilled an exploratory well at Hudson on an expiring Petroleum and Natural Gas Licence. While unsuccessful, the drilling allowed the Company to earn four sections of land with exploration potential.

### November Acquisition

Bellator established itself in the Lloydminster area by purchasing a private company in November, 1996 which had production of approximately 150 bopd and 500 mcf/d. Buzzard, the main producing property in the area, will be a key focus for Bellator in 1997.

### December Acquisition

An acquisition in December, 1996 in the Sounding-Hoosier area gave Bellator an additional 20,000 gross acres of land with an average working interest of 86 percent and production of 2.2 mmcf/d and 15 bopd from six producing wells. This acquisition increased Bellator's land position in the area to 67.5 sections of land, including 58 undeveloped sections, which have excellent exploration and development potential.

### January 1997 Acquisition

In January, 1997 Bellator signed a letter of intent to purchase a private company with properties in the Lloydminster area. Production from the properties comes from 11 producing wells and averages approximately 500 bopd. An extensive infill development program will be implemented to fully exploit these properties.

Also in January, 1997 Bellator signed an underwriting agreement to raise $8.0 million equity, conditional on closing the acquisition, to complete the purchase and fund a portion of the development program.

### Technical Expertise

Bellator has assembled a technical team which has been involved in our core areas for several years. Gary Anderson, P.Eng. has over 20 years of experience as a Petroleum Engineer with the previous four years being almost exclusively dedicated to working on the Sounding-Hoosier and Lloydminster areas.
Paul Whitby, M.Sc. has worked the Sounding-Hoosier area extensively over the last four years and is responsible for generating the majority of the prospects on the lands. This technical expertise gives Bellator a competitive advantage in both core areas.

# LAND AND RESERVES

## SUMMARY

As previously noted, Bellator has made several strategic acquisitions which significantly increased the Company's undeveloped land base and reserves. The following tables present the Company's land holdings and reserves as at December 31, 1996:

### Reserves

The Reserves of the Company, as at December 31, 1996 determined by independent consultants using escalated prices and costs:

| | Remaining Reserves | | Future Cash Flow | | | |
|---|---|---|---|---|---|---|
| | | | | Discounted | | |
| | Oil | Natural Gas | Undiscounted | at 10% | at 15% | at 20% |
| | (bbls) | (mmcf) | M$ | M$ | M$ | M$ |
| Proved Developed: | | | | | | |
| Producing | 359,684 | 4,193 | 10,244 | 7,346 | 6,442 | 5,745 |
| Non-producing | 806,110 | 2,082 | 15,835 | 8,735 | 6,972 | 5,754 |
| Proved Undeveloped | 478,066 | - | 6,064 | 3,779 | 3,119 | 2,629 |
| Total Proved | 1,643,860 | 6,275 | 32,143 | 19,860 | 16,533 | 14,128 |
| Probable Additional (risked @ 50%) | 432,303 | 1,099 | 8,319 | 4,097 | 3,106 | 2,440 |
| **TOTAL (1)** | **2,076,163** | **7,374** | **40,462** | **23,957** | **19,639** | **16,568** |

(1) No reserves have been assigned to Bellator's Joffre lands.

### Land Holdings

(as at December 31, 1996)

| | Developed Acres | | Undeveloped Acres | | Total Acres | |
|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net |
| Sounding-Hoosier (1) | 5,692 | 4,094 | 37,480 | 31,821 | 43,172 | 35,915 |
| Lloydminster | 960 | 960 | 1,320 | 1,320 | 2,280 | 2,280 |
| Joffre | 0 | 0 | 5,957 | 4,364 | 5,957 | 4,364 |
| **TOTAL** | **6,652** | **5,054** | **44,757** | **37,505** | **51,409** | **42,559** |

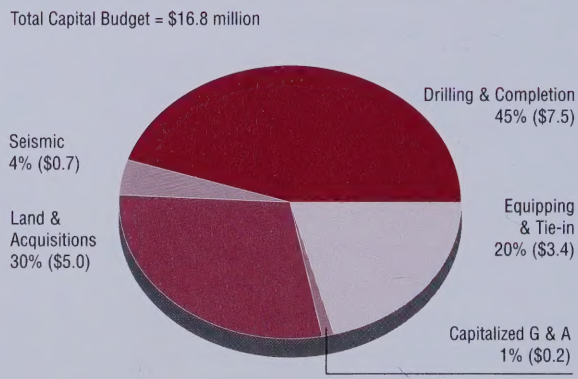
(1) The undeveloped lands have been evaluated by Seaton-Jordan at $2.3 million.

# OUTLOOK FOR 1997

Fiscal 1997 will see a continuation of the rapid growth that Bellator experienced in 1996, with production gains coming from the development of the Company's existing properties as well as the pending acquisition in the Lloydminster core area, scheduled to close in February, 1997.

Bellator's capital budget for 1997 is projected to be $16.8 million, with two-thirds allocated to drilling, completion, equipping and tie-ins. The Land and Acquisitions budget relates mainly to the acquisition previously noted.

## 1997 Capital Budget

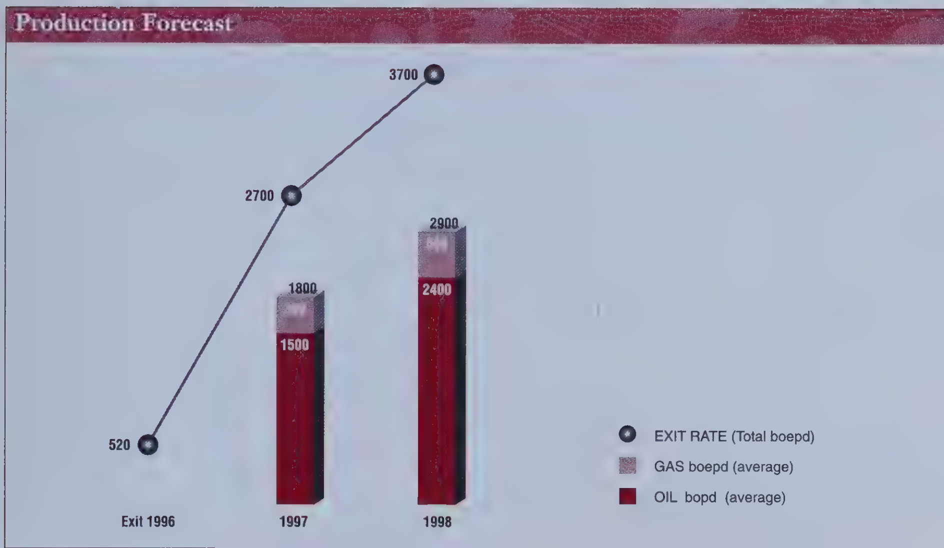



The table outlined below shows the anticipated development of Bellator's current properties. The majority of the drilling budget will be spent in the Lloydminster core area and will consist primarily of development wells. A small portion of the program has been allocated for exploratory wells, which are lower risk prospects in the Sounding-Hoosier core area.

## Drilling Projects Inventory

| | 1997 | 1998 |
|---|---|---|
| • Development | 28 | 24 |
| • Exploratory | 4 | 6 |
| | 32 | 30 |

All wells are 100% working interest.

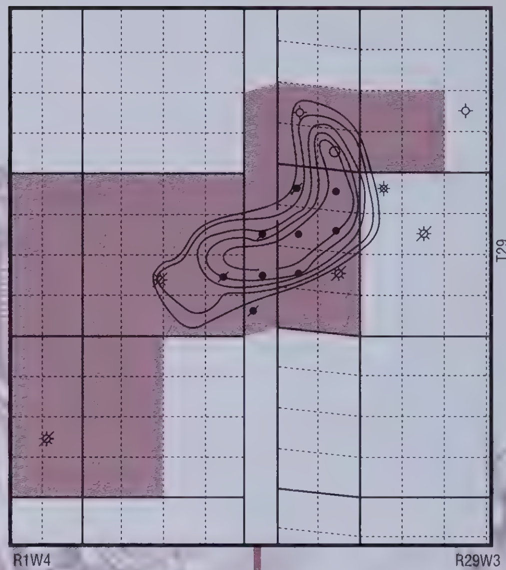



## PRODUCTION FORECAST

Bellator began fiscal 1997 with production of 1,020 boepd (including the acquisition which has an effective date of January 1, 1997 and is anticipated to close in February, 1997). Based on the current capital program, production is expected to increase five-fold from exit 1996 to exit 1997. The drilling program is expected to begin after spring break-up and will continue through summer.

Projected 1998 production increases are a result of the continuance of a large development program plus a small number of exploratory wells. Beyond 1998 the Company still has an abundance of ready to drill development locations and will continue to assess its large exploration base for further drilling.

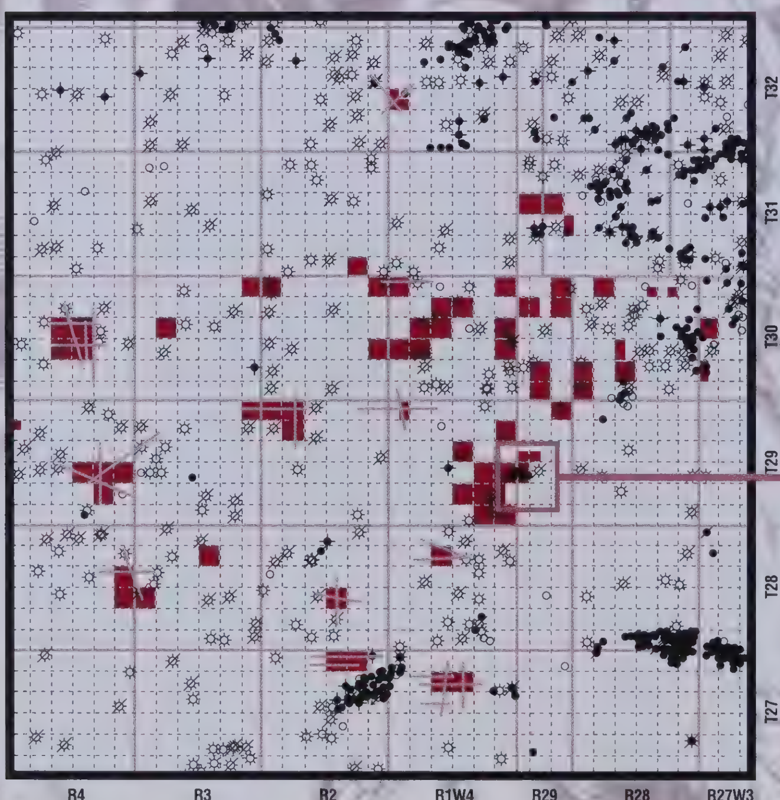
## Alsask Detrital Oil Pool




## Core Area I - Sounding-Hoosier

- Oil Well
- Gas Well
- Abandoned Oil Well
- Dry and Abandoned Well
- Drilling Location
- Suspended Oil Well
- Suspended Gas Well

## Sounding-Hoosier Core Area




Bellator Lands

# Core Area I Sounding-Hoosier

Bellator began to develop the Sounding area of east-central Alberta as a core property in September, 1995. The presence of shallow, stacked gas sands, prolific new oil plays and abundant acquisition candidates met our criteria for low cost development and balanced production.

In January, 1996 Bellator expanded its search for high quality acquisition and development properties to the oil-prone Hoosier area on the Saskatchewan side of the border, an area which included numerous underdeveloped Bakken, Detrital and Mannville oil pools.

Our large undeveloped land base in that area will be an important source of future growth for the Company. Interpretation of existing seismic, coupled with the shooting/purchasing of additional seismic, and mapping, will enhance Bellator's existing inventory of exploration prospects on its lands.

### Alsask

Bellator's Alsask Detrital oil pool produces from multiple, stacked unconsolidated pebble beds which combine to give a thick oil column over the pool area (see map).

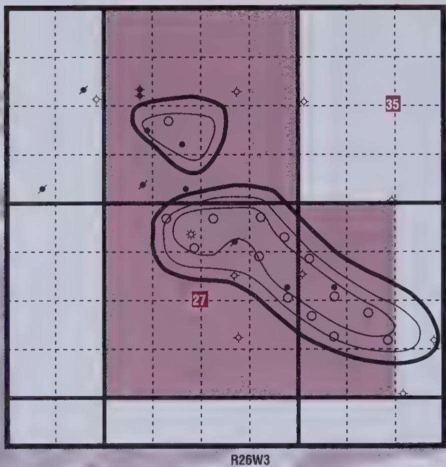
The November drilling program confirmed Bellator's technical interpretation that significant incremental oil recovery could be obtained from this formation, and as a result, ultimate oil recovery from the pool will be increased. In addition, successful testing of previously bypassed zones have extended the pool area and will provide new step-out drilling opportunities.

To address these new developments, Bellator will shoot a 3-D seismic program over the pool during the first half of 1997. This will further delineate the pool limits and aid in the implementation of a waterflood scheme. On full scale development this pool is projected to produce at rates of approximately 400 bopd.

### Antelope

The Antelope properties are located in the central portion of our Sounding-Hoosier core area. Bellator currently produces 2.2 mmcf/d and 15 bopd from these properties. In addition to exploration drilling potential, several different areas of optimization have been identified. We believe operating costs on existing gas wells can be reduced with no loss of efficiency or safety. Several gas wells which are capable of gas production in excess of 1 mmcf/d on a combined basis, are currently shut-in due to high water cuts. Bellator is reviewing these wells and our water disposal system to determine the steps necessary to bring these wells back on stream economically. Several "missed oil pay" prospects have been identified in existing wells and Bellator plans to develop these zones in the immediate future.

## Waseca Net Oil Pay

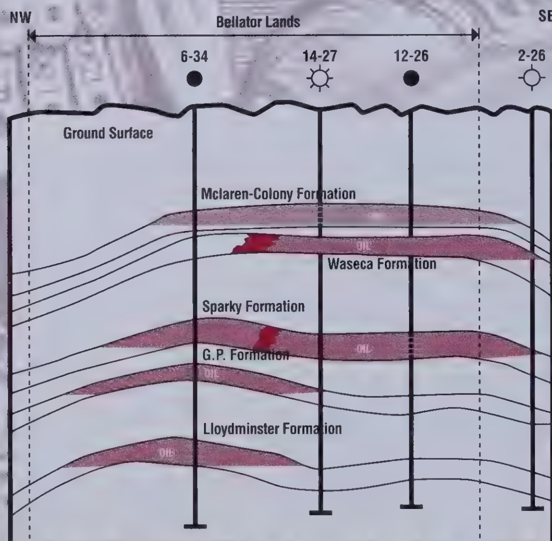



## Sparky Net Oil Pay

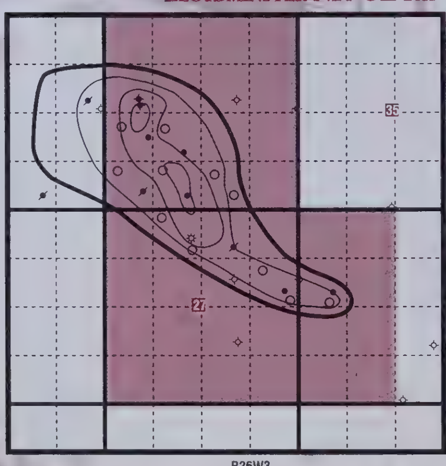

## Core Area II - Lloydminster Buzzard Property

- ● Oil Well
- ☼ Gas Well
- Abandoned Oil Well
- Dry and Abandoned Well
- ○ Drilling Location
- Suspended Oil Well
- Suspended Gas Well

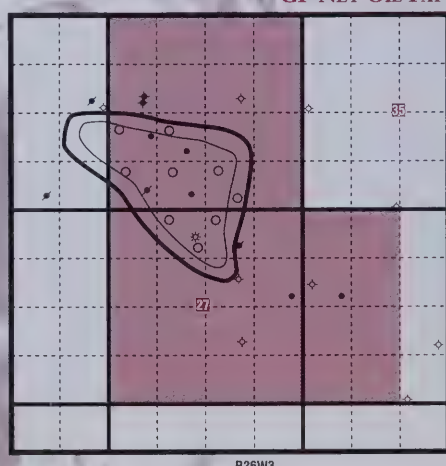
## Buzzard Cross-section




## Lloydminster Net Oil Pay




## GP Net Oil Pay



# Core Area II
# Lloydminster

The Lloydminster area is characterized by the presence of shallow stacked oil and gas bearing sands within the Lower Cretaceous Mannville Group, which are found at a depth of 450 to 600 metres. Low drilling costs and multi-zone potential, combined with improved production-based technology, were key factors in choosing the Lloydminster area.

## Buzzard Property

Bellator's main producing property in the Lloydminster core area is Buzzard, which is located approximately 20 miles southeast of the city of Lloydminster. The Buzzard property has five hydrocarbon bearing zones, including the McLaren, Waseca, Sparky, General Petroleum and Lloydminster formations.

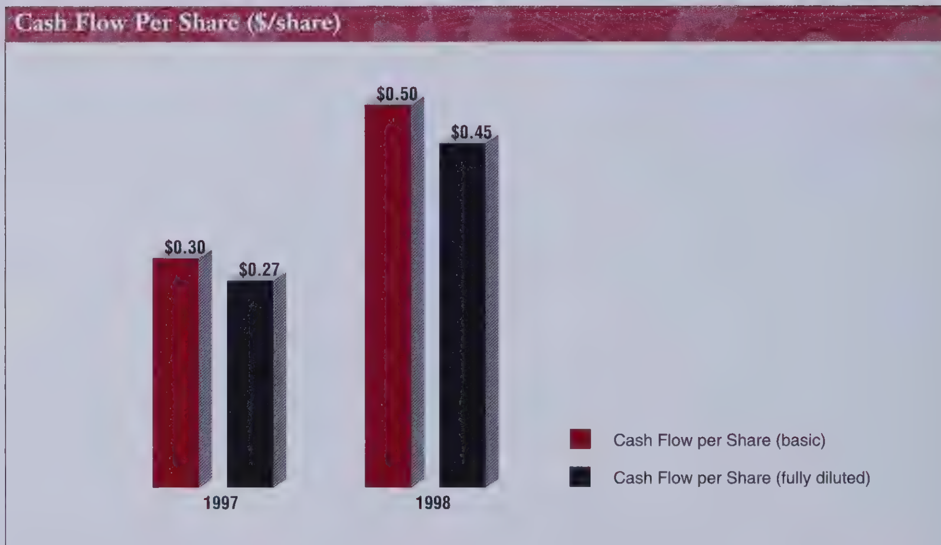
The Company has 1,600 acres of land in the Buzzard area with one producing gas well, two producing oil wells and five shut-in oil wells. The two producing oil wells are completed in the Sparky zone and average 80 bopd per well, while one well in the McLaren zone is producing gas at 500 mcf/d.

Development plans for 1997 include shooting a 3-D seismic program and drilling up to 12 development wells. Over the next several years, up to 43 development wells may be drilled on the existing lands. Under full scale development, the Buzzard property should achieve production rates of approximately 1,400 boepd.

## Summary

Bellator intends to continue to expand its presence in this core area by making strategic acquisitions to complement its development programs. The acquisition, scheduled to close in February, 1997 has properties that are very similar in nature to the Buzzard property, and has significant development potential. We believe that as our knowledge of the area continues to grow, other such opportunities will arise.

# Cash Flow Analysis




### Cash Flow Projections

Bellator has assembled a large reserve base with a proforma net asset value in excess of $2.00 per share. The graph displayed above illustrates the growth in cash flow that will be generated as Bellator exploits its large reserve base and begins to realize on its net asset value.

The anticipated cash flow per share of $0.30 in 1997, rising to $0.50 in 1998, shows the growth potential of the Company as the value of current reserves are captured and additional reserves are established.

Bellator's high net asset value combined with its cash flow growth and management expertise will result in increased shareholder value in the coming years.

The cash flow projections above were done on a proforma basis and include the previously discussed acquisition of a private company and a financing of $8,000,000 at $1.00 per share, both of which will close in February, 1997.

Assumptions used for 1997 include $US20 WTI oil pricing, $1.50 per mcf gas pricing, and completion of the $16.8 million capital program, but do not include any acquisitions other than noted above. For 1998, oil pricing was escalated at five per cent while gas pricing was held constant.

# Auditors' Report

January 24, 1997

**To the Shareholders of Bellator Exploration Inc.**

We have audited the balance sheets of Bellator Exploration Inc. as at December 31, 1996 and September 30, 1996 and the statements of operations and deficit and changes in financial position for the three months ended December 31, 1996 and the year ended September 30, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and September 30, 1996 and the results of its operations and the changes in its financial position for the three months ended December 31, 1996 and the year ended September 30, 1996 in accordance with generally accepted accounting principles.

Garrett Bauer

**Chartered Accountants**
**Calgary, Alberta**

# BALANCE SHEET

| | December 31 1996 | September 30 1996 | September 30 1995 |
|---|---|---|---|
| **Assets** | | | |
| Current assets: | | | |
| Cash | $ 51,852 | $ 268,714 | $ 711,465 |
| Accounts receivable | 232,147 | 77,432 | 118,136 |
| | 283,999 | 346,146 | 829,601 |
| Capital assets (Note 2) | 5,043,522 | 1,736,518 | 1,628,901 |
| | $ 5,327,521 | $ 2,082,664 | $ 2,458,502 |
| **Liabilities and Shareholders' Equity** | | | |
| Current liabilities: | | | |
| Accounts payable and accruals | $ 675,508 | $ 136,485 | $ 141,793 |
| Current portion of long-term debt | 475,000 | 166,667 | 120,000 |
| | 1,150,508 | 303,152 | 261,793 |
| Long-term debt (Note 3) | 1,455,000 | 355,000 | 675,000 |
| Provision for site restoration | 5,782 | 1,064 | 12,610 |
| Deferred income tax | 526,725 | 144,000 | – |
| Shareholders' equity: | | | |
| Share capital (Note 4 and 6) | 3,087,381 | 2,146,467 | 1,578,901 |
| Contributed surplus | 30,211 | 30,211 | 30,211 |
| Deficit | (928,086) | (897,230) | (100,013) |
| | 2,189,506 | 1,279,448 | 1,509,099 |
| | $ 5,327,521 | $ 2,082,664 | $ 2,458,502 |

Approved by the Board:

Director

Director

# Statement of Operations and Deficit

| | Three Months Ended December 31 1996 | Year Ended September 30 1996 | Year Ended September 30 1995 |
|---|---|---|---|
| **Revenue:** | | | |
| Oil and gas, net of royalties | $ 362,993 | $ 344,890 | $ 395,484 |
| **Expenses:** | | | |
| Production | 150,952 | 115,981 | 79,038 |
| General and administrative | 131,480 | 293,966 | 219,826 |
| Interest on long-term debt | 23,283 | 56,923 | 35,408 |
| Depletion and depreciation | 88,134 | 121,352 | 201,385 |
| | 393,849 | 588,222 | 535,657 |
| Loss before the following | (30,856) | (243,332) | (140,173) |
| Write-down of oil and gas properties | – | (553,885) | – |
| | (30,856) | (797,217) | (140,173) |
| Provision for income taxes (Note 5) | – | – | – |
| Loss for the period | (30,856) | (797,217) | (140,173) |
| Deficit, beginning of period | (897,230) | (100,013) | (384,560) |
| Reduction of stated capital (Note 6) | – | – | 424,720 |
| | (897,230) | (100,013) | 40,160 |
| Deficit, end of period | $ (928,086) | $ (897,230) | $ (100,013) |
| Loss per share | $ (0.002) | $ (0.071) | $ (0.016) |

# Statement of Changes in Financial Position

| | Three Months Ended December 31 1996 | Year Ended September 30 1996 | Year Ended September 30 1995 |
|---|---|---|---|
| Cash provided by (used in) | | | |
| **Operating activities:** | | | |
| Loss for the period | $ (30,856) | $ (797,217) | $ (140,173) |
| Items not affecting cash – | | | |
| Depletion and depreciation | 88,134 | 121,352 | 201,385 |
| Write-down of oil and gas properties | – | 553,885 | – |
| | 57,278 | (121,980) | 61,212 |
| Net change in non-cash working capital | 384,309 | 35,396 | 24,957 |
| | 441,587 | (86,584) | 86,169 |
| **Financing activities:** | | | |
| Increase (decrease) in long-term debt | 1,408,333 | (273,333) | 420,000 |
| Issuance of share capital | 1,323,639 | 711,566 | 535,250 |
| | 2,731,972 | 438,233 | 955,250 |
| **Investing activities:** | | | |
| Purchase of capital assets | (3,390,421) | (1,925,588) | (340,670) |
| Proceeds on sale of capital assets | – | 1,131,188 | – |
| | (3,390,421) | (794,400) | (340,670) |
| Increase (decrease) in cash | (216,862) | (442,751) | 700,749 |
| Cash, beginning of period | 268,714 | 711,465 | 10,716 |
| Cash, end of period | $ 51,852 | $ 268,714 | $ 711,465 |

## 1 Significant accounting policies:

**[a] Petroleum and natural gas properties and equipment**

The Company follows the full cost method of accounting whereby all costs of exploring for and developing oil and gas reserves are capitalized and charged against earnings as set out below. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges of non-producing properties, costs of drilling both productive and non-productive wells and overhead charges directly related to acquisition, exploration and development activities.

These costs, together with the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated gross proved reserves as determined by independent petroleum engineers. Oil and natural gas reserves and production are converted into equivalent units based upon estimated relative energy content of ten thousand cubic feet of natural gas to one barrel of oil.

The capitalized costs less accumulated depletion, depreciation and the provision for future removal and site restoration costs are limited to an amount equal to the estimated undiscounted future net revenue from proved reserves, based on year end prices, plus the cost (net of impairments) of unproved properties less estimated future removal and site restoration, general and administrative, financing and income tax costs.

Proceeds from the sale of oil and gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would result in a change in the rate of depletion of 20% or more.

**[b] Office equipment**

Equipment not directly related to the operations of the petroleum and natural gas interests is stated at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful life of five years.

**[c] Provision for site restoration costs**

The estimated costs for future removal and site restoration, net of estimated salvage values, are provided for on the unit-of-production method. Estimated costs are based on engineering estimates in accordance with regulations in effect at year end. The annual charge is included in depletion and depreciation expense and actual site restoration expenditures are charged to the accumulated provision account as incurred.

**[d] Joint venture accounting**

A portion of the Company's oil and gas activities are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

**[e] Earnings per share**

Earnings per share has been calculated using the weighted average number of shares outstanding during the year.

## 2 Capital assets

| | December 31, 1996 | | | September 30, 1996 | | | September 30 |
|---|---|---|---|---|---|---|---|
| | 1996 | | | 1996 | | | 1995 |
| | Cost | Accumulated Depletion and Depreciation | Net Book Value | Cost | Accumulated Depletion and Depreciation | Net Book Value | Net Book Value |
| Oil and gas properties | $ 5,100,443 | $ 92,979 | $ 5,007,464 | $ 1,713,207 | $ 11,971 | $ 1,701,236 | $ 1,607,414 |
| Office equipment | 52,453 | 16,395 | 36,058 | 49,269 | 13,987 | 35,282 | 21,487 |
| | $ 5,152,896 | $ 109,374 | $ 5,043,522 | $ 1,762,476 | $ 25,958 | $ 1,736,518 | $ 1,628,901 |

As at December 31, 1996 the cost of oil and gas properties includes $1,643,533 relating to properties from which there is no production and which have been excluded from costs subject to depletion and depreciation.

As at September 30, 1996 the cost of oil and gas properties includes $923,815 (1995 - $100,000) relating to properties from which there is no production and which have been excluded from costs subject to depletion and depreciation.

## 3 Long-term debt

| | December 31 1996 | September 30 1996 | September 30 1995 |
|---|---|---|---|
| Debentures payable, unsecured, bearing interest at 10% (payable semi-annually), maturing on May 31, 1998. The debentures are convertible at the option of the holder (Note 4(e)). | $ 355,000 | $ 355,000 | $ 355,000 |
| Revolving operating demand loan bearing interest at 1% above prime. Interest is accrued daily and paid monthly. While there is no principal repayment schedule, the loan is reviewed annually and is secured by a $2,000,000 fixed and floating debenture. | 125,000 | – | – |
| Demand note payable, secured by a first, fixed and floating charge on certain properties, bearing interest at prime plus 2% with no fixed terms of repayment. | 700,000 | – | – |
| Term loan, payable under a demand production loan facility and bearing interest at 1 1/2% above prime. While the bank indebtedness is of a demand nature, the lender has agreed to accept 48 monthly payments of $15,625 plus interest and is secured by a fixed and floating charge debenture over all assets of the Company. | 750,000 | – | – |

| | | | |
|---|---|---|---|
| Note payable, unsecured, bearing interest at prime, repayable quarterly in the amount of $33,333.33 plus interest. | – | 166,667 | – |
| Term loan, payable under a demand production loan facility and bearing interest at 1 1/2% above prime. While the bank indebtedness is of a demand nature, the lender has agreed to accept monthly payments of $10,000 plus interest and is secured by a $2,000,000 fixed and floating debenture over all present and future property and personal guarantees by certain of the directors. | – | – | 440,000 |
| | 1,930,000 | 521,667 | 795,000 |
| Less: amount due within one year | 475,000 | 166,667 | 120,000 |
| | $ 1,455,000 | $ 355,000 | $ 675,000 |

Estimated principal repayments are as follows:

| | | |
|---|---|---|
| 1997 | - | $ 475,000 |
| 1998 | - | $ 705,000 |
| 1999 | - | $ 350,000 |
| 2000 | - | $ 350,000 |
| 2001 | - | $ 50,000 |

## 4 SHARE CAPITAL

**[a] Authorized**

Unlimited voting common shares

Unlimited preferred shares

**[b] Issued and outstanding common shares**

| | December 31 1996 | | September 30 1996 | | September 30 1995 | |
|---|---|---|---|---|---|---|
| | Number of Shares | Amount | Number of Shares | Amount | Number of Shares | Amount |
| Balance, beginning of period | 12,734,250 | $ 2,146,467 | 9,560,250 | $ 1,578,901 | 8,121,750 | $ 1,468,371 |
| Shares issued for cash | 3,645,000 | 1,275,750 | 1,600,000 | 320,000 | 1,438,500 | 561,750 |
| Share issue costs | – | (22,861) | – | (1,934) | – | (26,500) |
| Reduction of stated capital (Note 6) | – | – | – | – | – | (424,720) |
| Shares issued in acquisition of capital assets | – | – | 1,400,000 | 350,000 | – | – |
| Shares issued in settlement of liabilities | 283,000 | 70,750 | 174,000 | 43,500 | – | – |
| Tax effect of flow through shares | – | (382,725) | – | (144,000) | – | – |
| Balance, end of period | 16,662,250 | $ 3,087,381 | 12,734,250 | $ 2,146,467 | 9,560,250 | $ 1,578,901 |

**[c] Escrow shares**

At September 30, 1995 500,003 common shares were held in escrow (December 31, 1996 - Nil, September 30, 1996 - Nil).

**[d] Stock options**

Pursuant to the directors, officers, employees and consultants stock option plan, the Company has options outstanding as at December 31, 1996 totalling 1,650,000 which have exercise prices from $0.25 per share to $0.52 per share and expire between September 30, 1998 and November 30, 2001. In addition, a financial institution holds an option to purchase 5,000 common shares at $0.44 per share.

**[e] Convertible debentures**

The debentures are convertible at the option of the holder at a conversion price of $0.50 per common share until May 31, 1996; $0.55 per common share from June 1, 1996 to May 31, 1997; and $0.60 per common share from June 1, 1997 to May 31, 1998. Of the $355,000 debentures issued, $55,000 were issued to directors of the Company.

**[f] Flow through shares**

During the period ended December 31, 1996 the Company issued 3,645,000 common shares for gross proceeds of $1,275,750 of which $850,500 are flow through. The tax effect of $382,725 has reduced share capital. During the year ended September 30, 1996 the Company issued 1,600,000 (1995 - 136,500) common shares pursuant to a flow through share offering for gross proceeds of $320,000 (1995 - $40,950). The tax effect of $144,000 (1995 - $Nil) has reduced share capital.

## 5 INCOME TAXES

The provision for income taxes in the Statement of Operations varies from the amount that would be computed by applying the expected income tax rate of 45% to net earnings (loss) before income taxes. The reasons for the difference between such expected income tax expense (recovery) and the amount recorded are as follows:

| | **Dec. 31 1996** | **Sept. 30 1996** | Sept. 30 1995 |
|---|---|---|---|
| Expected income tax expense (recovery) | **$ (13,883)** | **$ (358,748)** | $ (61,676) |
| Increase (decrease) in income taxes resulting from: | | | |
| Non-deductible crown charges | **20,059** | **7,168** | 16,267 |
| Depletion of non-tax base assets | **20,024** | **20,688** | 79,416 |
| Resource allowance | **(16,392)** | **–** | (83,965) |
| Non-deductible write-off of capital assets | **–** | **249,248** | – |
| Tax benefit not recognized on current year losses | **–** | **86,470** | 68,331 |
| Utilization of loss carry forwards | **(7,337)** | **–** | – |
| Other | **(2,471)** | **(4,826)** | (18,373) |
| | **$ –** | **$ –** | $ – |

The Company has non-capital losses carried forward from current and prior years that may be used to reduce future years' taxable income. These losses approximate $650,000 and expire in various years to 2003.

The potential benefits relating to the available losses have not been recognized in the accompanying financial statements.

A significant portion of the petroleum and natural gas interests have been acquired at a book value that is greater than their inherent tax values and as a result, incomes taxes may be payable sooner than would otherwise be the case and effective income tax rates may be higher than expected. The net book value in excess of cost basis for income tax purposes is approximately:

| | |
|---|---|
| **December 31, 1996** | **$ 2,660,000** |
| **September 30, 1996** | **$ 760,000** |
| **September 30, 1995** | **$ 780,000** |

## 6 Reduction of stated capital

The stated capital of the Company was reduced by $424,720 on March 16, 1995 by way of shareholder resolution. The reduction has been recorded as a decrease to share capital and a decrease to the deficit at September 30, 1995.

## 7 Contingency

The Company is subject to extensive environmental laws and regulations. These laws, which are constantly changing, include regulations covering the discharge of materials into the environment. Management of the Company believes that it is in compliance with existing laws and regulations.

## 8 Subsequent events

**Issuance of share capital**
In January, 1997 the Company entered into an underwriting agreement to sell up to 8,000,000 Special Warrants at $1.00 each. The Special Warrants will be convertible into common shares on a one for one basis. The offering is contingent on closing the acquisition of a private company as noted below.

**Sale of capital assets**
In January, 1997 the Company sold all of its assets in the Joffre area which consisted of undeveloped land and a small unit interest producing 1.2 barrels of oil per day (net), for proceeds of $1,600,000.

**Purchase of capital assets**
In January, 1997 the Company entered into an agreement to acquire a private company with production of approximately 500 barrels of oil per day. The acquisition is conditional upon the execution of a mutually agreeable purchase and sale agreement and satisfactory due diligence review.

# Corporate Information

## OFFICERS AND DIRECTORS

**Robert J. Zakresky**, CA*
*President and Director*

**Robert T. Jepson**, BBA.PLM.
*V. P. Land and Director*

**Gary L. Anderson**, P. Eng.
*V. P. Operations*

**Donald McMorland**, P. Geol.*
*Director*

**Sean M. Monaghan**, CA, CBV*
*Director*

** Member of the Audit Committee*

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(Symbol "BEX")

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## NOTICE OF ANNUAL GENERAL MEETING

The Annual General Meeting of Bellator Exploration Inc. will be held on Thursday, March 27, 1997 at 3:00 pm in The McMurray Room, *The Calgary Petroleum Club*, 319 - Fifth Avenue S.W., Calgary, Alberta.

## ABBREVIATIONS

| | |
|---|---|
| bbls | barrels |
| bopd | barrels of oil per day |
| boe | barrels of oil equivalent |
| boepd | barrels of oil equivalent per day |
| mmcf | million cubic feet |
| mmcf/d | million cubic feet per day |
| bcf | billion cubic feet |
| section | 640 acres |
| M$ | thousands of dollars |
| WTI | West Texas Intermediate |

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